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ALEXANDER L. STEVENS,  
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IN THE  
**Supreme Court of the United States**  
 OCTOBER TERM, 1984

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BOARD OF GOVERNORS OF THE  
 FEDERAL RESERVE SYSTEM

v.

**DIMENSION FINANCIAL CORP., et al.**

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**On Petition for Writ of Certiorari to the United States  
 Court of Appeals for the Tenth Circuit**

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**JOINT BRIEF OF RESPONDENTS IN OPPOSITION**

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JOHN D. HAWKE, JR.  
 Counsel of Record  
 LEONARD H. BECKER  
 DOUGLAS L. WALD  
 ARNOLD & PORTER  
 1200 New Hampshire  
 Avenue, N.W.  
 Washington, D.C. 20036  
 (202) 872-6700  
*Counsel for Respondents*  
*American Financial Services*  
*Association, Household*  
*Finance Corporation, and*  
*First Bancorporation*

JEFFREY S. DAVIDSON  
 Counsel of Record  
 DENNIS M. GINGOLD  
 GLENN SUMMERS  
 HARRY J. KELLY  
 KIRKLAND & ELLIS  
 655 Fifteenth Street, N.W.  
 Washington, D.C. 20005  
 (202) 879-5000  
*Counsel for Respondents*  
*Dimension Financial*  
*Corporation, Daniel T. Carroll,*  
*Harold D. Dufek, William*  
*L. Mitchell, Ronald L. Shaffer,*  
*and A. Gary Shilling*

[List of Counsel Continued on Inside Cover]

JAMES D. BLOUNT, JR.  
Counsel of Record  
JOHN L. JERNIGAN  
R. MARKS ARNOLD  
SMITH, ANDERSON, BLOUNT,  
DORSETT, MITCHELL &  
JERNIGAN  
Post Office Box 12807  
Raleigh, North Carolina 27605  
(919) 821-1220

*Counsel for Respondent  
Financial Institutions  
Assurance Corporation*

THOMAS B. RIDGLEY  
Counsel of Record  
VORYS, SATER, SEYMOUR AND  
PEASE  
52 East Gay Street  
P.O. Box 1008  
Columbus, Ohio 43216  
(614) 464-6400

*Counsel for Respondents  
Ohio Deposit Guarantee Fund,  
Horizon Savings & Loan  
Company, Horizon Service  
Corporation, and Permanent  
Savings & Loan Association*

ANTHONY J. CELEBREZZE, JR.  
Attorney General  
JOEL S. TAYLOR, Chief Counsel  
Counsel of Record  
ATTORNEY GENERAL OF OHIO  
State Office Tower, 17th Floor  
30 East Broad Street  
Columbus, Ohio 43215  
(614) 466-4320

*Counsel for Respondents  
State of Ohio and Ohio  
Division of Savings & Loan  
Associations*

LOUIS A. HELLERSTEIN  
Counsel of Record  
STEPHEN A. HELLERSTEIN  
HELLERSTEIN, HELLERSTEIN &  
SHORE, P.C.  
1139 Delaware Street  
P.O. Box 5637  
Denver, Colorado 80217  
(303) 573-1080

*Counsel for Respondents  
Colorado Industrial Bankers  
Association and Ft. Lupton,  
Monroe, Castle Rock and Ark  
Valley Industrial Banks*

## **STATEMENT OF CORPORATE AFFILIATIONS OF RESPONDENTS**

The Respondents joining in this Brief in Opposition are:

Dimension Financial Corporation and members of its Board of Directors, Daniel T. Carroll, Harold D. Dufek, William L. Mitchell, Ronald L. Shaffer, and A. Gary Shilling. Dimension is a corporation that has applied to the Office of the Comptroller of the Currency for authorization to establish and operate thirty-one national banks in twenty-five states. Dimension is affiliated with Financial Investments Inc., a savings and loan service corporation and a wholly-owned subsidiary of Valley Federal Savings and Loan Association of Hutchins, Kansas;

American Financial Services Association, a national trade association of companies engaged in the consumer financial business;

Household Finance Corporation ("HFC"), which operates various financial institutions throughout the country, including numerous industrial banks and industrial loan corporations chartered in Colorado, Utah, Kansas, and Iowa, and which is a wholly-owned subsidiary of Household International, Inc.; First Bancorporation, a Utah bank holding company;

Colorado Industrial Bankers Association ("CIBA"), an association of industrial banks chartered in the state of Colorado;

Fort Lupton Industrial Bank, a subsidiary of Midwest Bancshares, Inc., Monroe Industrial Bank, an industrial bank owned by nine individual investors, Castle Rock Industrial Bank, a subsidiary of 405 Corporation, Ark Valley Industrial Bank, a subsidiary of 405 Corporation, Household Weld County Industrial Bank, Household Lamar Industrial Bank,

Household Alamosa Industrial Bank, Household Valley Industrial Bank, and Household Salida Industrial Bank, all of which are members of CIBA, and the last five of which are subsidiaries of HFC;  
Financial Institutions Assurance Corporation, a state-regulated, private deposit insurer;  
The State of Ohio and the Ohio Division of Savings and Loan Associations; and  
The Ohio Deposit Guarantee Fund, Horizon Savings & Loan Association, Horizon Service Corporation, and Permanent Savings & Loan Association.

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## JOINT BRIEF OF RESPONDENTS IN OPPOSITION

## STATEMENT OF THE CASE

In *Dimension Financial Corp. v. Board of Governors*, 744 F.2d 1402 (10th Cir. 1984), the court below invalidated an amended Board regulation that expanded the definition of “bank” and the Board’s resultant jurisdiction under the Bank Holding Company Act of 1956 (“BHCA” or “Act”), 12 U.S.C. §§ 1841-1850 (1982).<sup>1</sup> Any company that is a “bank holding company” is subject to pervasive regulation by the Board under the BHCA.

<sup>1</sup> A recent order of the court of appeals clarified that its decision is limited to the portion of the regulation concerned with the “bank” definition. See Addendum A to the Documentary Supplement lodged with the Clerk of this Court. The Documentary Supplement contains materials referred to in this brief. Documents found in the administrative record of this case are cited here as “R. at —, Addendum —.”

See BHCA §§ 3-4, 12 U.S.C. §§ 1842-1843. A "bank holding company" is "any company which has control over any bank." BHCA § 2(a)(1), 12 U.S.C. § 1841(a)(1). "Bank" is defined in pertinent part as "any institution . . . which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." *Id.* § 2(c), 12 U.S.C. § 1841(c).

The original 1956 Act defined "bank" broadly to include "any national banking association or any State bank, savings bank, or trust company." Congress twice restricted the scope of the BHCA, and the Board's jurisdiction thereunder, by narrowing the definition of "bank" in the Act: first, in 1966, by excluding companies that do not accept deposits which the depositor has a legal right to withdraw on demand; and, second, in 1970, by excluding companies that do not engage in the business of making commercial loans.<sup>2</sup>

The matter at issue in this case is the December, 1983 decision of the Board to recast the two key provisions of the Act's definition of "bank." The Board amended its Regulation Y, which implements the BHCA, to define "deposits that the depositor has a legal right to withdraw on demand" as "any deposit with transactional capability that, *as a matter of practice*, is payable on demand . . . ." 12 C.F.R. § 225.2(a)(1)(ii)(A) (1984) (emphasis added).

The Board defined "commercial loan" to include a number of short-term investment vehicles that financial institutions have historically employed to make use of temporarily idle funds for the purpose of asset-liability man-

<sup>2</sup> See S. Rep. No. 1179, 89th Cong., 2d Sess. 7, reprinted in 1966 U.S. Code Cong. & Ad. News 2385, 2391 ("1966 Senate Report"); and S. Rep. No. 1084, 91st Cong., 2d Sess. 24, reprinted in 1970 U.S. Code Cong. & Ad. News 5519, 5541 ("1970 Senate Report").

agement, including the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, the extension of broker call loans, the sale of federal funds and the deposit of interest-bearing funds. 12 C.F.R. § 225.2(a)(1)(ii)(B).<sup>3</sup>

The avowed purpose of these definitional changes was to extend the Act to reach so-called "nonbank banks"—institutions that were not previously subject to the Board's jurisdiction under the BHCA, because they did not engage in both of the activities identified in the two-pronged definition of "bank" in the Act. Such institutions either (i) offer NOW accounts with respect to which the depositor does not have a legal right to withdraw deposits on demand, or (ii) do not engage in the business of making commercial loans. See App. at 24a-25a. However, the effect of the new definitions was not limited to "nonbank banks." A number of other longstanding institutions, such as state-chartered and -insured savings and loan associations, would now be subject to the Act.<sup>4</sup>

<sup>3</sup> The new definitions in amended Regulation Y restated positions first announced by the Board in two 1982 rulings. The Board first announced its redefinition of "legal right" to mean "as a matter of practice" for purposes of BHCA § 2(c)(1) in its *First Bancorporation* decision, 68 Fed. Res. Bull. 253 (1982). The Board first announced that its definition of "commercial loans" included investment instruments like certificates of deposit in its December, 1982 "Dreyfus" letter to the Federal Deposit Insurance Corporation (FDIC). See Appendix to the Board's Petition for a Writ of Certiorari, 6a-7a. References to the Board's Petition are cited here "Petition at \_\_\_\_"; references to the Appendix to the Petition are cited "App. at \_\_\_\_."

<sup>4</sup> See, e.g., Federal Reserve Press Release at 7 (December 29, 1983), R. at 1627, Addendum B (noting that "[u]nder the revised regulation" companies that own "savings and loan associations, the accounts of which are not insured by the Federal Savings and Loan Insurance Corporation and that offer NOW accounts and make commercial loans" must register as "bank holding companies" and "conform [their] activities to [the Act].").

The Board's new definitions were sharply criticized by other banking regulators, as well as by members of the financial community. The Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC") both asserted that the definitions had no statutory basis and emphasized that the definition of "bank" was a jurisdictional matter properly addressed only by Congress.<sup>5</sup>

Three Federal Reserve Banks also objected to the Board's definitions. The Federal Reserve Bank of Atlanta stated that "[s]ince the new definition of commercial loans has no basis in tradition or in the BHC Act it appears to provide an overly broad extension of the regulation." R. at 358, Addendum E. The Federal Reserve Bank of San Francisco agreed, noting that "we are not convinced that the Board's expansive reading of 'bank' is justified, or that Congress intended that so-called 'nonbank banks' be subject to Board authority under the Bank Holding Company Act." R. at 312, Addendum F. The Federal Reserve Bank of Chicago termed the Board's commercial loan definition "unduly restrictive." R. at 370, Addendum G.

The Board's isolation within the Government on this issue has only increased since the decision of the court below. The Department of the Treasury has indicated its belief that the court reached the right result. See Letter from Donald T. Regan, then Secretary of the Treasury, to A. J. King, President, Independent Bankers Association of America (Nov. 30, 1984), Addendum H ("[T]he chartering of nonbank banks is permitted under present law. This fact was supported most recently by the 10th Circuit's decision in *Dimension Financial Corporation v. Board of Governors of the Federal Reserve*

<sup>5</sup> See R. at 444, Addendum C (OCC Comment Letter); *id.* at 477, Addendum D (stating that the FDIC was "deeply concerned over the Board's attempt to resolve by regulation outstanding policy issues that are better left to Congress.").

*System.*"). The Department of Justice has determined not to join the Board in this Petition for a Writ of Certiorari. The Solicitor General's Office merely authorized the Board to file on its own behalf, and the United States Government is thus not a party to the Board's petition. The Comptroller of the Currency, the primary regulator of national banks, was "strongly opposed to the filing of this petition."<sup>6</sup>

#### REASONS FOR DENYING THE PETITION

The issues in this case fundamentally pose legislative rather than judicial questions and are therefore inappropriate for Supreme Court review. Under the guise of statutory interpretation, the Board is attempting to resolve administratively the issues of what its jurisdiction under the BHCA *ought* to be and what the overall framework of federal banking regulation *ought* to be in light of changes the Board perceives in the financial marketplace. These are questions which necessarily involve legislative judgments concerning conditions in the current marketplace, political compromises among competing interests, and coordination of potential changes in the BHCA with other related banking regulatory statutes. The underlying character of the issues in this case, and the lack of merit in the Board's statutory interpretation, suggest that review of the lower court decision should be denied and that resolution of the policy

<sup>6</sup> Letter to Lawrence G. Wallace, Deputy Solicitor General, from Richard V. Fitzgerald, Chief Counsel, Office of the Comptroller of the Currency (February 5, 1985), Addendum I at 1. Earlier, the Comptroller's legal staff informed the Justice Department that "certiorari ought not to be sought" in this case and that the "limitations and restrictions" contained in Regulation Y "are unwarranted by applicable statute." Letter to Robert E. Kopp, Director, Appellate Staff, Civil Division, Department of Justice, from Eugene M. Katz, Assistant Director, Litigation Division, Office of the Comptroller of the Currency (November 30, 1984), Addendum J at 1. These letters were obtained through a Freedom of Information Act request.

issues raised by the Board should remain where they properly belong—in Congress.

1. As the Board notes, Congress has been considering and is currently considering the issue of the Board's jurisdiction. *See Petition at 24 n.18.* A comprehensive banking bill (S. 2851) that, among other things, would have changed the BHCA definition of bank passed the Senate last session but was not acted on by the House. Five bills have been introduced in the current session that address the structure of federal regulation of financial institutions, including the Board's jurisdiction under the BHCA.<sup>7</sup> The issue of the Board's jurisdiction is thus receiving active Congressional consideration, and Congress has the power to change the definition of "bank" if Congress deems fit.

2. Despite the Board's effort to justify the "bank" definition in terms of halting the expansion of so-called "nonbank banks" until Congress can act (*see Petition at 23-24 & n.18*), the reality is that, *with Board approval*, nonbank banks are continuing to be authorized despite the Board's new definition. Therefore, reversal of the lower court would not halt the expansion of "nonbank banks" which the Board now claims to fear, and will not measurably contribute to the Board's professed goal of giving Congress time to act.

The proliferation of nonbank bank applications that the Board so decries in its Petition stems in large part from the Board's own decision in *U.S. Trust Corporation*, 70 Fed. Res. Bull. 371 (1984), which the Board neglects to mention in its petition.<sup>8</sup> In that proceeding, the Board, acting on an application under section 6 of the BHCA, permitted a New York bank holding company to expand the activities of its existing nonbank subsidiary in Florida to include the acceptance of time and demand deposits

(including checking accounts) and the making of consumer loans, but excluding the making of commercial loans as defined by the Board in its amended Regulation Y. The Board believed that approval of U.S. Trust's application "present[ed] a serious potential for undermining the policies of the Act," but pronounced itself "constrained by the definition of bank in the Act to approve the application." 70 Fed. Res. Bull. at 372. The Board's ruling came five months before the decision of the court of appeals below.

The Board's favorable action on U.S. Trust's application triggered a flurry of activity by other banking institutions already subject to the Board's jurisdiction under the BHCA, similarly seeking to broaden their multi-state presence through the "consumer bank" approach. According to a tabulation compiled by the Comptroller of the Currency, between March 30, 1984 and October 30, 1984 (the latter date being approximately one month after the court of appeals decision below), the federal banking authorities had received 334 applications for authority to charter interstate "non-bank banks" or to expand trust company powers—all but 19 of them within 90 days after the Board's decision in *U.S. Trust*. Office of the Comptroller, "Summary of Non-Bank Bank Applications" (Nov. 1, 1984), Addendum K.

In a series of rulings following its *U.S. Trust* decision, the Board has continued to approve bank holding company applications to acquire or establish "nonbank banks" outside the States of their respective incorporation. In at least one such case, the Board has approved the application on the ground that the "nonbank banks" to be acquired will not accept demand deposits as the Board has defined that term in its amended Regulation Y.<sup>9</sup> In other such rulings, the Board has granted ap-

<sup>7</sup> S. 510, H.R. 15, H.R. 20, H.R. 428, and H.R. 1276.

<sup>8</sup> A petition for review is pending. *Florida Bankers Ass'n v. Board of Governors*, No. 84-3269 (11th Cir. filed Apr. 23, 1984).

<sup>9</sup> *Irving Bank Corporation*, 71 Fed. Res. Bull. —, —, slip op. at 2 (Jan. 31, 1985).

proval on the ground that the "nonbank banks" to be acquired will refrain from making "commercial loans" as the Board has defined that term in the revised Regulation Y.<sup>10</sup> In each instance, the Board has pronounced itself "constrained by the technical definition of 'bank' in the Act" to arrive at its decision, and has expressed the need for congressional action to amend the statute.

In short, the "tide" of applications about which the Board expresses so much concern "[i]f the Tenth Circuit's decision is left intact" (see Petition at 22) has not been caused by the court decision below. Rather, those applications would continue even if the court below were reversed. The Board itself acknowledges that only Congress has the power to address the problem the Board perceives.

3. That the issue of what is a "bank" for the purposes of the BHCA is one properly resolved by Congress is further demonstrated by the disruption that the Board's new definition of this term would cause in the existing structure of banking regulation. The Board claims that the additional jurisdiction implicit in the new Regulation Y definition is necessary to avoid "chang[ing] the face of banking in the United States." Petition at 23. In reality, however, the Board's action disrupts a number of other statutory schemes and institutional relationships, distorting the structure of banking regulation that Congress has carefully constructed over the years.

While purportedly aimed at "nonbank banks," the Board's expansion of the term "bank" brings under the Act a number of institutions that have long existed with-

<sup>10</sup> Bankers Trust New York Corporation, 71 Fed. Res. Bull. 51 (1984); Suburban Bancorporation, 71 Fed. Res. Bull. 61 (1984); First National State Bancorporation, 71 Fed. Res. Bull. 115 (1984); Maryland National Corporation, 71 Fed. Res. Bull. — (Feb. 4, 1985); Mellon National Corporation, 71 Fed. Res. Bull. — (Feb. 13, 1985).

out being subject to the Act. Even the Board recognizes that its definition sweeps under the Act institutions that Congress did not intend to be subject to the Act's provisions.<sup>11</sup> The new Regulation Y attempts to cure this anomalous result by permitting such companies to "petition the Board for relief on grounds of hardship or unfairness." R. at 1627, Addendum B. But such "grandfathering" of institutions to exempt them from a statute's coverage is clearly a legislative activity and merely underscores the essentially legislative character of the Board's new regulation, as the court below noted. App. at 18a.<sup>12</sup>

Subjecting to the Act institutions not intended by Congress to be covered conflicts with existing statutory provisions. Perhaps the most dramatic example concerns the BHCA requirement that a "bank" subject to the Act must obtain FDIC insurance. BHCA § 3(e), 12 U.S.C. § 1842(e). The Board's new definition of "bank" transforms certain institutions, such as state-chartered savings and loans that are *ineligible* for FDIC insurance, into "banks." Remarkably, the Board "resolves" this dilemma by dictating to Congress a deadline in which to pass legislation ending the statutory conflict created by the Board's new definition:

The Board notes that, under the Act, an institution that qualifies as a bank under the Board's interpretation and that is owned by a company would be al-

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<sup>11</sup> As discussed *infra* at section 7, pp. 20-22, the Board's bank definition even brings back under the Act the particular institution, Boston Safe, that Congress specifically intended to exclude from the Act's coverage through the 1970 amendments.

<sup>12</sup> See *In Re Surface Mining Regulation Litigation*, 627 F.2d 1346, 1358-59 (D.C. Cir. 1980): "The law does not permit an agency to exercise powers expressly denied it by Congress if it includes a variance mechanism that perhaps will be used to bring the agency's regulations within the boundaries established by the statute."

lowed two years to obtain FDIC insurance. This will provide time for Congress to consider amending section 3(e) of the Act to allow other types of qualified insurance as an alternative to FDIC insurance. App. at 44a.

Another disruption caused by the Board's new definition affects the private deposit insurance system. As an alternative to FDIC or FSLIC insurance, many states permit state-regulated private deposit insurance corporations. This system has received Congressional recognition, for example, in the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469. However, the Board's expansion of the definition of "bank" will force many of the institutions that currently use private deposit insurance to terminate such insurance and instead obtain FDIC or FSLIC insurance, thereby in effect forcing the "federalization" of the deposit insurance system. This interference with a state-created, congressionally approved system—part of the wider dual banking system approved by Congress<sup>13</sup>—belies the Board's professed wish to avoid "distorting the balance between state and federal bank regulations struck by Congress" (Petition at 23), as one of the reasons for its expanded definition of "bank." *See* App. at 8a.

While the Board argues that Regulation Y is intended to stabilize the nation's banking system (*see* Petition at 24-25), the court below correctly recognized the far-reaching effects of the Board's definition and the pervasive disruption of the status quo in the American financial community that it would engender:

[The Board's definition] was to cause pervasive changes, thus to cause existing businesses to suddenly become bank holding companies and to necessitate reversal of acquisitions and to bring about divesti-

<sup>13</sup> *See* S. Rep. No. 536, 97th Cong., 2d Sess., *reprinted in* 1982 U.S. Code Cong. & Ad. News 3054, 3069.

tures; to change the investments permitted of state chartered savings and loans; and to have other consequences on existing business. It affected other regulatory agencies. For example, the changes required federal deposit insurance for entities which had insurance under state funds and other funds. It required entities to obtain such insurance which were not eligible for it. In short, the changes in definitions and the jurisdiction of the Board would cause extensive changes by other agencies and of course by some entities providing financial services to the public. (App. at 5a).

These far-reaching effects demonstrate that the Board's new definitions cannot be squared with the intent of Congress as a matter of statutory construction. For purposes of consideration of the Board's Petition, these effects also demonstrate the legislative nature of the issues created by the change in the Board's jurisdiction. Any change in that jurisdiction has a ripple effect on related laws and on existing institutions. Therefore, any such change should occur only through Congressional evaluation of the country's system of financial institution regulation.

4. Board statements acknowledge that its new and expanded definition of "bank" constituted a legislative response to a perceived need for a change in its jurisdiction to counted developments in the marketplace. In 1983, the Board proposed for introduction into Congress a bill that would have put a moratorium on any further developments in the banking system through broadening the definition of "bank" in the RHCA.<sup>14</sup> Board Chairman Volcker testified that "[w]e do think that the enactment of a temporary moratorium will give you [Congress] a

<sup>14</sup> The bill, S. 1532, defined "bank" as any institution insured by the FDIC. *See* Moratorium Legislation and Financial Institutions Deregulation: Hearings on S. 1532, S. 1609, and S. 1682 Before the Senate Comm. on Banking, Housing and Urban Affairs, 98th Cong., 1st Sess. 2 (1983) ("Moratorium Legislation Hearings").

little breathing room.”<sup>15</sup> Congress did not enact the Board’s requested moratorium, and Senator Garn, Chairman of the Senate Banking Committee, expressed disapproval of the Board’s proposal.<sup>16</sup> Yet the Board subsequently justified its revision of Regulation Y as necessary to halt change in the financial marketplace “in order to avoid the preemption of Congressional discretion.” App. at 61a. In effect, the Board has taken an action purportedly to provide Congress with “a little breathing room” that the Board—but not Congress—thinks Congress needs.

5. The final confirmation of the legislative and political nature of the Board’s action is the isolation of the Board within the Government on this issue. As noted above, Congress refused the Board’s request to broaden the definition of bank as a stop-gap measure.<sup>17</sup> The Board’s fellow banking regulators—the OCC and the FDIC—have stated that the definition of “bank” and the delineation of the Board’s powers are matters for Congress. The Treasury Department has indicated that broad-based legislation, not unilateral Board action, is the proper way to deal with developments in the marketplace. *See Addendum H* at 2. Even some of the Board’s constituent Federal Reserve banks stated that the Board’s definitions constituted “an overly broad extension of the regulation”

and expressed doubt that “Congress intended [the] so-called ‘nonbank banks’ [to] be subject to Board authority under the Bank Holding Company Act.” R. at 358, Addendum E; R. at 312, Addendum F.

As these other governmental entities recognize, the extent of the Board’s jurisdiction and the shape of federal financial regulation are legislative issues properly resolved by Congress. These issues should therefore be left to Congress through a denial of the Board’s petition.

6. In addition to appropriating legislative responsibility, the Board’s definitions are invalid strictly as a matter of straightforward statutory interpretation, as held by the lower court. The lower court recognized the present action is a jurisdictional matter, exclusively involving questions of statutory interpretation. App. at 4a-5a. The court below correctly determined that the Board misconstrued both components of the BHCA’s bank definition. The Board’s definition of “deposits which the depositor has a legal right to withdraw” simply rewrites the statute, changing “legal right” to “as a matter of practice.” The Board’s definition of “commercial loans” conflicts with the plain meaning and Congressional intent behind the inclusion of the term in the BHCA.

a. The Board’s admitted purpose in rewriting Congress’ definition of “bank” under the BHCA was to enlarge the statutory net to reach financial institutions otherwise not subject to the Board’s jurisdiction. Such entities now include industrial banks and industrial loan corporations that offer NOW accounts—that is, interest-bearing savings accounts, maintained by natural persons and nonprofit corporations, from which the customer may make withdrawals by negotiable draft as well as by personal presentation of his passbook. Typically, NOW account customers do not have the *legal right* to withdraw their NOW account deposits on demand. By law, institu-

<sup>15</sup> Moratorium Legislation Hearings at 140.

<sup>16</sup> *See id.* at 83 (remarks of Senator Garn). The Administration also opposed the Board’s moratorium. *Id.* at 65 (testimony of then Secretary Regan).

<sup>17</sup> Several individual legislators have criticized the Board for appropriating a legislative function. For example, Senator Abdnor wrote the Board to question whether it was appropriate for the Board to promulgate rule changes while Congressional consideration was ongoing (R. at 500, Addendum L). *See also* R. at 521 (Representative Parris), at 525 (Representative Shumway), at 526 (Senator Simpson), at 529 (Senator Trible), at 530 (Representative Vento), and at 532 (Representative Dreier) (Addenda M-R).

tions that offer NOW accounts *must* reserve the right to require written notice before the customer withdraws his funds. This is true at both the federal and state levels.<sup>18</sup>

The "legal right" test for the "demand deposit" aspect of the BHCA's definition of "bank" has been on the statute books since 1966. But it was not until 1982 that the Board first declared that offering NOW accounts brings financial institutions within the Act's definition of "bank." In *First Bancorporation*, 68 Fed. Res. Bull. 253 (1982), a bank holding company organized under Utah law and controlling a state-chartered bank in Salt Lake City sought leave to acquire a Utah industrial loan company, Beehive Thrift & Loan. The Board conditionally approved First Bancorporation's acquisition, subject to a comprehensive array of restrictions predicated on the Board's conclusion that Beehive was a "bank" under the BHCA because it offered NOW accounts and made commercial loans.

In *First Bancorporation v. Board of Governors*, 728 F.2d 434 (10th Cir. 1984) (the "Beehive" decision), a panel of the court of appeals below set aside the Board's ruling. The court held that the Board could not lawfully treat Beehive as a "bank" for purposes of the BHCA because Beehive's NOW accounts were subject under Utah law to the industrial loan company's reservation of the right to require 30 days' notice from account holders prior to withdrawal. Far from "acknowledg[ing] . . . that

<sup>18</sup> The reserved right to require advance notice is a universal feature of NOW accounts. Federal law prohibits the payment of interest on demand deposits by Federal Reserve members, 12 U.S.C. § 371a (1982), and by FDIC-insured institutions, 12 U.S.C. § 1828(g). Federal law permits such institutions to pay interest on NOW accounts, 12 U.S.C. § 1832(a), but only because such accounts are subject to the reserved right to require notice of withdrawal. 12 C.F.R. §§ 217.1(e) & 329.1(e)(2) (1984).

Similarly, Respondents are aware of no state—and the Board has identified none—where financial institutions offer NOW accounts *without* reserving the right to require notice prior to withdrawal.

NOW accounts are, in operation, identical to checking accounts," as the Board now contends (Petition at 12), the court of appeals in *Beehive* came to the contrary conclusion:

NOW accounts differ legally as well as in form from demand deposits. The substantive differences include that NOW accounts bear interest, are unavailable to certain depositors [principally corporations and for-profit business organizations], and cannot be subject to a legal right of withdrawal on demand under Utah law. (728 F.2d at 436).

The Board unsuccessfully applied to the court of appeals for rehearing of its *Beehive* decision, but sought no further judicial review.<sup>19</sup>

On petition for review of the Board's rulemaking order amending Regulation Y, the court below properly concluded that the challenge to the "demand deposit" prong of the Board's redefinition of "bank" presented no issues not previously considered in its *Beehive* decision. Petition at 4a, 18a. Accordingly, the court reaffirmed its prior analysis, rejecting the Board's purported expansion of the "bank" definition insofar as "demand deposits" were concerned.

b. The legislative history of the definition of "bank" in section 2(c) of the BHCA shows that when Congress used the phrase "legal right to withdraw on demand," it meant what it said. As originally enacted in 1956, the BHCA defined "bank" as "any national banking association, or any State bank, savings bank, or trust com-

<sup>19</sup> In its order adopting the revised definition of "bank" under Regulation Y, the Board concededly did no more than codify its *Beehive* decision, which at the time was pending on review before the court of appeals. The Board acknowledged that a reversal in *Beehive* would compel it to reconsider its revised "bank" definition under Regulation Y. 49 Fed. Reg. 798-99 (1984); R. at 1652, Addendum S. However, no such reconsideration was forthcoming following the court of appeals' *Beehive* decision.

pany . . . ." Act of May 9, 1956, ch. 240, § 2(c), 70 Stat. 133. Under that definition, the Board issued two controversial rulings in which it applied the Act to industrial banks. In "Applicability of the Bank Holding Company Act to Industrial Banks," 49 Fed. Res. Bull. 165 (1963), the Board acknowledged that the Act "was directed principally at control of 'commercial' banks," and that "'industrial banks' . . . were not regarded as being engaged in commercial banking." *Id.* at 166. Nonetheless, the Board ruled that the acquisition of an industrial bank would be subject to the BHCA if "it accepts deposits subject to check or otherwise accepts funds from the public that are, *in actual practice, repaid on demand*, as are demand or savings deposits held by commercial banks." *Id.* at 166 (emphasis added).<sup>20</sup>

During hearings on proposed amendments to the BHCA in 1966, witnesses called upon Congress to overturn the Board's application of the Act to industrial banks. *Hearings on S. 2353, S. 2418, and H.R. 7371 Before a Sub-comm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 155-57, 394-95 (1966) (the "1966 Senate Hearings"). In a letter to the committee, the Board recognized a distinction between deposits that "in practice" are paid on demand and deposits that are truly "payable on demand." The Board also agreed that by redefining "a bank" as an institution that "accepts deposits payable on demand," the BHCA henceforth would exclude institutions that required notice before repaying deposits, even if in practice the institutions permitted withdrawals of such deposits "on demand." Letter of Board of Governors (April 20, 1966), 1966 Senate Hearings at 447.

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<sup>20</sup> Two years later the Board reaffirmed its position in "Industrial Banks as 'Banks' under Bank Holding Company Act," 51 Fed. Res. Bull. 1539-40 (1965). There the Board ruled that the Act applied to industrial banks issuing investment certificates that were "repaid, *in practice, on demand*." *Id.* at 1540 (emphasis added).

Congress went one step farther than the Board recommended. To ensure that an industrial bank that in practice repays deposits "on demand" without legal compulsion to do so is not a "bank" covered by the BHCA, Congress limited the definition of "bank" to "any institution that accepts deposits that the depositor has a *legal right to withdraw on demand . . .*" Bank Holding Company Act Amendments of 1966, Pub. L. No. 89-485, § 3, 80 Stat. 236 (emphasis added). Congress thereby expanded on the Board's concession and overrode the Board's two prior rulings on the subject. Congress used the words "legal right to withdraw on demand" in section 2(c) to exclude institutions that reserve the right to require notice before allowing their customers to withdraw funds, even if *in practice* the institutions permit withdrawals on demand.

Congress also made it clear that industrial banks were to be beneficiaries of the new statutory language. The Senate Report accompanying the 1966 BHCA amendments explained that one pertinent objective of the legislation was to ensure that the Act did *not* cover industrial banks: "[T]he bill redefines 'bank' as an institution that accepts deposits payable on demand (checking accounts), the commonly accepted test of whether an institution is a commercial bank *so as to exclude institutions like industrial banks . . .*" 1966 Senate Report, 1966 U.S. Code Cong. & Ad. News at 2391 (emphasis added). Senator Robertson said: "This definition clearly excludes industrial banks." 112 Cong. Rec. 12,388 (1966). The Board has conceded that the 1966 Amendments to the BHCA "were designed to exclude from coverage under the Act . . . industrial banks." App. at 24a.

In *Beehive*, the court of appeals correctly held that the legislative history of the "demand deposit" definition in the BHCA compelled rejection of the Board's approach:

Congress rejected the Board's suggested amendment [in 1966 to the existing statutory language] which would have read merely 'payable on demand.' Con-

gress therefore overturned the Board's interpretation by substituting the '*legal right* to withdraw' language for the Board's right to withdraw on demand *in actual practice* provision. That differentiation, in the words of the Senate Banking Committee chairman, 'clearly excludes industrial banks.' . . . No room exists for an argument that a practice as to NOW accounts should prevail rather than the statute. (728 F.2d at 436-37) (emphasis in original).<sup>21</sup>

c. The Board's revised definition of "demand deposits" runs counter to the Board's own regulations. The Board has distinguished interest-bearing savings accounts from demand deposits in two of the most important regulatory schemes promulgated and administered by the agency—its Regulations D and Q, which impose, respectively, reserve requirements and interest-rate limitations on deposits in covered depository institutions. 12 C.F.R.

<sup>21</sup> The Board contends that the legislative history of the 1966 amendment somehow supports its revision of Regulation Y, evidently on the theory that Congress considered the use of check-like instruments of withdrawal to be the litmus test for "banks" under the Act. Petition at 11-12 & n.6. But the legislative record is devoid of evidence that Congress had any such idea in mind when it redefined "bank" to exclude institutions where customers had the ability *in practice* to withdraw funds on demand, without the *legal right* to do so. The Congressional objective in amending § 2(c) in 1966 was not to establish a particular instrument of withdrawal as the talisman for determining whether an institution is a "bank." Rather, Congress repudiated the Board's earlier decisions that the Act encompassed industrial banks that "in practice" allowed customers to withdraw deposits on demand—decisions that did not turn on the type of instrument used to effect withdrawals.

Thus, Congress established that an institution reserving the right to require notice before paying *any* instrument of withdrawal—be it check, draft, or withdrawal slip—could not be deemed a "bank" under the Act. If Congress had intended to base the statutory test in § 2(c) on the available means of withdrawal, rather than on the customer's *legal right* to withdraw on demand, it easily could have defined "banks" in terms of deposits from which withdrawals may be made by negotiable instruments, as the Board now attempts to do by administrative fiat. Congress did not do so.

§§ 204, 217 (1983). In recent years, the Board has amended Regulations D and Q to provide for NOW accounts. In both regulatory schemes, the Board has declined to classify NOW accounts as "demand deposits." Instead, it has given express legal effect to the reserved right to require notice of withdrawal in treating NOW accounts as *savings* deposits. 12 C.F.R. §§ 204.2(b) (1) & (d) (1) (1984) (Regulation D); *id.* § 217.1(e) (3) (1984) (Regulation Q).<sup>22</sup>

d. The Board's reliance upon *Wilshire Oil Co. v. Board of Governors*, 668 F.2d 732 (3d Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982), is misplaced. There a bank holding company already in control of a commercial bank sought to evade the Board's jurisdiction by causing its bank subsidiary, the Trust Company of New Jersey, to advise customers holding non-interest-bearing demand deposits (*i.e.*, traditional checking accounts) that henceforth the Trust Company would reserve the right to require prior notice of withdrawal, but that it had "no intention of exercising" that right. 668 F.2d at 733-34. By this transparent device, the Trust Company sought to convert its conventional checking accounts into something other than "demand deposits." Its objective was to evade the coverage of the BHCA, so that its corporate parent could continue to engage in the oil business, an activity impermissible for a bank holding company.

The Board concluded that the Trust Company should be treated as a "bank" under the Act, because the Trust Company remained "an institution that accepts checking accounts, including those of business organizations."

<sup>22</sup> Even under the BHCA, prior to the abrupt policy reversal in *First Bancorporation*, the Board consistently ruled that financial institutions offering NOW accounts and making commercial loans were not "banks" under the Act because NOW accounts are not demand deposits. *See, e.g.*, First Financial Group of New Hampshire, Inc., 66 Fed. Res. Bull. 594, 594 (1980); Heritage Banks, Inc., 66 Fed. Res. Bull. 917 (1980).

*Wilshire Oil Co.*, No. 1114026, slip op. at 16 (Apr. 2, 1981). The Board further ruled that the sole purpose of the Trust Company's purported notice had been to evade the strictures of the Act. *Id.* at 18.<sup>23</sup>

The Court of Appeals for the Third Circuit affirmed on the ground that the Board properly had found that the Trust Company's purported reservation of the right to require advance notice of withdrawals from its checking accounts had no effect on its existing status as a "bank" under the BHCA. 668 F.2d at 740. The court of appeals noted that even after its notice to depositors, the Trust Company continued to refer to its deposits as "demand deposits," *id.* at 738 n.11; that the accounts at issue were non-interest-bearing, *id.* at 737 n.8; and that federal law restricted NOW accounts (which bear interest) to individuals and nonprofit corporations—a restriction not adopted by the Trust Company. *Id.*

The court of appeals in *Wilshire* did not suggest that financial institutions such as industrial banks or savings and loan associations could be brought wholesale within the BHCA by equating NOW accounts with demand deposits, or that regulation of all such institutions was necessary to prevent "evasions" of the Act. Thus, there is no conflict between the Tenth Circuit's decision and the *Wilshire* holding. See *Beehive*, 728 F.2d at 436.

7. a. The "commercial loan" component of the Board's new Regulation Y contradicts the Congressional intent behind the 1970 BHCA amendments, which inserted the provision into the definition of "bank" in order to re-

<sup>23</sup> As the Board recently told the Court of Appeals in the Eleventh Circuit, *Wilshire* is a case "where a financial institution whose activities *already satisfied the definition of 'bank'* sought to place itself outside of the [BHC] Act's coverage without altering any of the banking activities actually performed by the bank." Brief for Board at 28, *Florida Bankers Ass'n v. Board of Governors*, No. 84-3269 (11th Cir. Sept. 24, 1984) (emphasis added).

strict the Act's coverage to those entities which genuinely implicate the underlying purposes of the Act. As noted, the purposes of the BHCA are "to restrain undue concentration of *commercial* banking resources and to prevent possible abuses related to the control of *commercial* credit." 1970 Senate Report, 1970 U.S. Code Cong. & Ad. News at 5541 (emphasis added). The Board's revised Regulation Y, however, redefines so broadly the "commercial loan" component of the BHCA's definition of "bank" that it sweeps into the scope of the BHCA financial institutions which do not engage in traditional commercial lending and, accordingly, do not implicate the underlying purposes of the BHCA. In short, the Board has used the "commercial loan" component, a provision intended to restrict the scope of the BHCA and limit the Board's jurisdiction, to expand the BHCA's coverage and thus broaden the Board's authority. Neither result was intended by Congress.

The clearest demonstration that the new Regulation Y over-extends the scope of the BHCA is that it subjects to the BHCA institutions like Boston Safe Deposit & Trust Co. ("Boston Safe"), institutions that Congress expressly intended to exclude from the Act's coverage through the 1970 amendment. The legislative history of the BHCA demonstrates that Congress meant to exclude from the statute institutions which, like Boston Safe, made no commercial loans. 116 Cong. Rec. 25,848 (1970). As the Senate Report accompanying the 1970 amendment explains, the earlier 1966 amendments were "designed to include commercial banks and exclude those institutions not engaged in commercial banking." 1970 Senate Report, 1970 U.S. Code Cong. & Ad. News at 5541.<sup>24</sup> To realize

<sup>24</sup> Indeed, according to the 1970 Senate Report, the Board itself recognized that the BHCA's earlier definitions of "bank" were too broad and might "include institutions which are not in fact engaged in the business of commercial banking in that they do not make commercial loans." *Id.*

this goal fully, Congress in 1970 adopted the “commercial loan” component of the BHCA’s definition of “bank,” to exclude institutions that are not engaged in the business of making commercial loans from the definition of ‘bank.’” *Id.* Congress expressly cited Boston Safe as an example of the kind of institution which should be excluded from the BHCA’s coverage, because it made no commercial loans.<sup>25</sup>

Therefore, one thing is manifest from the legislative history of the 1970 amendment—“commercial loans” did not include the kind of activities engaged in by institutions like Boston Safe. In 1970, Boston Safe purchased commercial paper, certificates of deposit and bankers’ acceptances and sold federal funds. R. at 921B, Addendum T. In 1972, the Board confirmed that these transactions did not constitute making commercial loans for purposes of the amended BHCA. R. at 1014R, Addendum U.

The Board’s new Regulation Y, however, sweeps back into the BHCA institutions like Boston Safe, the very institutions Congress exempted in 1970. Because Regulation Y nullifies this central, restrictive purpose of the 1970 legislative action, the Board’s interpretation is invalid as a matter of legislative interpretation. That the Board now would include under the BHCA institutions which Congress explicitly excluded is the clearest indication that the new Regulation Y contradicts the Congressional intent behind the 1970 BHCA amendments.

b. Contrary to the Board’s assertion, Congress understood the plain meaning of “commercial loan” in 1970 and had definite purposes for including the term in the

<sup>25</sup> 116 Cong. Rec. 25,848 (1970). There is no indication that Congress intended to exclude only Boston Safe or only trust companies from the BHCA’s coverage. Rather, Congress intended to exempt any institutions that “are not in fact engaged in the business of commercial banking in that they do not make commercial loans.” 1970 Senate Report, 1970 U.S. Code Cong. & Ad. News at 5541.

BHCA. Commercial loans typically involve a direct extension of credit by a commercial bank to a non-banking enterprise for an extended period at an interest rate negotiated by the parties.<sup>26</sup> Such close lender-borrower relations may pose potential problems of improper credit tying and discriminatory credit favoritism. Thus, commercial loans were understood by Congress to be those active forms of lending that posed the potential for abuse that the BHCA was intended to prevent.<sup>27</sup>

The nation’s financial institutions have historically dealt in other, passive investment vehicles, termed interbank and “money market” instruments, which have never been considered commercial loans. These money market instruments, typically used by financial institutions to invest temporarily idle funds on a short-term basis, involve no close lender-borrower relationship and so lack the potential for abuse that the BHCA was intended to prevent. Yet, although money market instruments are distinguishable from commercial loans and do not pose the potential for abuse that underlies the BHCA, they are precisely the instruments the Board’s new Regulation Y now labels “commercial loans.”<sup>28</sup>

<sup>26</sup> A bank loan to an enterprise to build a new manufacturing facility or to fund inventory is an example of a typical commercial loan, as historically defined.

<sup>27</sup> 1970 Senate Report, 1970 U.S. Code Cong. & Ad. News at 5541. Indeed, if Congress had wished to extend the BHCA’s scope to all institutions that engage in transactions that “establish a debtor-creditor relationship and constitute an extension of credit or loan,” as the Board now interprets the BHCA (App. at 46a), it could easily have done so. The fact that Congress chose the narrower “commercial loan” formulation demonstrates further the kinds of investments Congress meant to exclude and the restrictive scope Congress intended for the BHCA.

<sup>28</sup> Included in Regulation Y’s redefinition of “commercial loan” are certificates of deposit, commercial paper, bankers’ acceptances, broker call loans and sales of federal funds. A bankers’ acceptance

The Board and its staff have consistently held that each of the money market instruments now captured by Regulation Y does not constitute commercial lending as defined by the BHCA. As noted, the Board in 1972 determined that Boston Safe's transactions in commercial paper, certificates of deposit, bankers' acceptances and federal funds did not constitute commercial lending for purposes of the BHCA. *See supra* at 22. In 1976 the Board staff determined that broker call loans did not constitute commercial loans.<sup>29</sup> In 1980, the Board's legal division held that the purchase of the guaranteed portions of Small Business Administration and Farmers Home Administration loans through nonbank dealers on the secondary market did not constitute commercial lending.<sup>30</sup> This consistent line of construction was summarized by the Board's staff in an internal 1981 memorandum which concluded that the purchase of federal funds

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is a time draft drawn on and accepted by a financial institution. Freund, *Investment Fundamentals* 188 (1983) (American Banking Association publication). Like commercial paper, bankers' acceptances are short-term, non-interest-bearing notes sold at a discount and redeemed at face value. Stigum, *The Money Market* 40 (rev. ed. 1983). Broker call loans are loans made to securities brokers and dealers on a day-to-day basis. Freund at 185. Federal funds transactions involve sales, often on an overnight basis, to another bank of reserves on deposit with the Board that are in excess of the selling bank's reserve requirements. *Id.* at 39.

<sup>29</sup> R. at 1014Y-Z, Addendum V. The Board's attorneys concluded that such money market transactions were a passive medium of investment and did

not appear to have the close lender-borrower relationship that is one of the characteristics of commercial loans and which presents the possibility of abuses relating to the control of commercial credit that concerned the Congress in adopting the commercial lending test. (*Id.* (emphasis added)).

<sup>30</sup> R. at 1014CC, Addendum W. Like broker call loans, these investments did not present the danger for abuse of commercial credit to which the BHCA was directed. *Id.*

and money market instruments did not constitute commercial loans, nor were broker call loans or sold securities transactions considered commercial loans for purposes of the BHCA.<sup>31</sup>

Thus, for more than a decade following the 1970 amendments to the BHCA, the Board and its staff distinguished commercial loans from the passive investment vehicles now included in the new Regulation Y definition. Only in 1982, with its "Dreyfus Letter," followed in 1983 with the release of the Regulation Y amendments, did the Board abruptly change course. In extending the definition of commercial loan to cover money market instruments, the Board has therefore contradicted its own consistent interpretations, as well as the historic understanding of the term "commercial loan" in the financial industry.<sup>32</sup> Most important, the Board also nullified the distinction between commercial loans and other forms of investment which was the basis for the 1970 BHCA amendments.

Changes in American banking since the enactment of the BHCA have not altered the investment practices of

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<sup>31</sup> R. at 1014V, Addendum X. Here again, the Board's staff had no trouble distinguishing these passive investments that "did not involve the particular type of lender-borrower relationship that is one of the characteristics of commercial loan[s] . . ." *Id.*

<sup>32</sup> Contrary to its assertion (Petition at 19 n.13), the Board's reversal of its long-standing interpretation of commercial loan is not a simple change of agency policy. Instead, by redefining the commercial loan provision, the Board has reconstructed the statute to extend the Board's jurisdiction beyond the bounds intended by Congress. The Board cannot expand its jurisdiction by such a device. Moreover, the Board's only complete public explanation for the revisions to Regulation Y's bank definition was contained in an Appendix released with the final draft of the revised regulation. Thus, affected parties were precluded from giving their comments on the Board's alleged rationale for the revisions. No explanation can be considered "adequate" when it is kept from the public until the time for comment is past.

institutions like Boston Safe so as to suddenly make them "banks" for purposes of the BHCA. Nor has it affected the essential differences recognized by Congress in the 1970 BHCA amendments between commercial loans and other forms of investment. All that has changed is the Board's definition of "commercial loan," as a device to expand the Board's jurisdiction over the nation's financial industry.

If, as the Board asserts, the evolution in the form and function of the nation's banking structure has somehow "outdated" the BHCA, then Congress must be the institution to recast the scope of the BHCA and the extent of the Board's jurisdiction thereunder. Although the Board may be impatient with the pace of this activity, any perceived delay merely reflects the absence of a consensus about what action, if any, is now required, and moreover suggests that the Board's views have not gained wide acceptance. In no event do such circumstances justify the Board's unilateral rewriting of the terms of a statute and resulting expansion of its jurisdiction, particularly when the Board's action contradicts the plain and historically accepted meaning of the statute's terms and the intent of Congress.

#### CONCLUSION

The court of appeals correctly held that the Board's definition of "bank" in the amended Regulation Y was improper. The underlying issues of the Board's jurisdiction and the overall framework of federal banking regulation are under consideration in Congress, where they properly belong. Accordingly, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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JOHN D. HAWKE, JR.  
Counsel of Record  
LEONARD H. BECKER  
DOUGLAS L. WALD  
ARNOLD & PORTER  
1200 New Hampshire  
Avenue, N.W.  
Washington, D.C. 20036  
(202) 872-6700  
*Counsel for Respondents*  
*American Financial Services  
Association, Household  
Finance Corporation, and  
First Bancorporation*

---

JEFFREY S. DAVIDSON  
Counsel of Record  
DENNIS M. GINGOLD  
GLENN SUMMERS  
HARRY J. KELLY  
KIRKLAND & ELLIS  
655 Fifteenth Street, N.W.  
Washington, D.C. 20005  
(202) 879-5000  
*Counsel for Respondents*  
*Dimension Financial  
Corporation, Daniel T. Carroll,  
Harold D. Dufek, William  
L. Mitchell, Ronald L. Shaffer,  
and A. Gary Shilling*

---

JAMES D. BLOUNT, JR.  
Counsel of Record  
JOHN L. JERNIGAN  
R. MARKS ARNOLD  
SMITH, ANDERSON, BLOUNT,  
DORSETT, MITCHELL &  
JERNIGAN  
Post Office Box 12807  
Raleigh, North Carolina 27605  
(919) 821-1220  
*Counsel for Respondent*  
*Financial Institutions  
Assurance Corporation*

---

ANTHONY J. CELEBREZZE, JR.  
Attorney General  
JOEL S. TAYLOR, Chief Counsel  
Counsel of Record  
ATTORNEY GENERAL OF OHIO  
State Office Tower, 17th Floor  
30 East Broad Street  
Columbus, Ohio 43215  
(614) 466-4320  
*Counsel for Respondents*  
*State of Ohio and Ohio  
Division of Savings & Loan  
Associations*

---

THOMAS B. RIDGLEY  
Counsel of Record  
VORYS, SATER, SEYMOUR AND  
PEASE  
52 East Gay Street  
P.O. Box 1008  
Columbus, Ohio 43216  
(614) 464-6400  
*Counsel for Respondents*  
*Ohio Deposit Guarantee Fund,  
Horizon Savings & Loan  
Company, Horizon Service  
Corporation, and Permanent  
Savings & Loan Association*

---

LOUIS A. HELLERSTEIN  
Counsel of Record  
STEPHEN A. HELLERSTEIN  
HELLERSTEIN, HELLERSTEIN &  
SHORE, P.C.  
1139 Delaware Street  
P.O. Box 5637  
Denver, Colorado 80217  
(303) 573-1080  
*Counsel for Respondents*  
*Colorado Industrial Bankers  
Association and Ft. Lupton,  
Monroe, Castle Rock and Ark  
Valley Industrial Banks*